

124 FERC ¶ 61,171
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Sudeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

Westar Energy, Inc.

Docket No. ER08-1149-000

ORDER ESTABLISHING HEARING AND SETTLEMENT JUDGE PROCEDURES

(Issued August 20, 2008)

1. On June 23, 2008, Westar Energy, Inc. (Westar) filed what it characterizes as a Petition for Approval of Settlement Agreement (Settlement Agreement) between Westar and the City of Elwood, Kansas (Elwood) requesting the Commission to approve without condition or modification the Settlement Agreement and an associated *pro forma* rate schedule (Cost-Based Formula Rate Agreement for Full Requirements Electric Service) between Elwood and Westar (Formula Rate Agreement).
2. As discussed below, this order sets Westar's proposed Formula Rate Agreement for hearing and settlement judge procedures.

I. Background

3. Westar is a public utility primarily engaged in the generation, transmission, distribution and sale of electric energy with its principal office located in Topeka, Kansas. Westar's transmission system is located in eastern and central Kansas and is under the control of the Southwest Power Pool, Inc. (SPP), which is a Commission-approved regional transmission organization. Westar provides firm capacity and energy to Elwood pursuant to an Agreement for Wholesale Electric Service (WES Agreement) between Elwood and Westar effective August 1, 1988. The WES Agreement is a fixed-rate agreement for bundled service. The WES Agreement had an initial term of ten years that was amended to twenty years, commencing on August 1, 1988.
4. Elwood is a municipality located in Doniphan County, Kansas. Elwood purchases electric power and energy and sells it to its customers within the franchised or certificated retail service territory that it has a statutory or contractual obligation to serve.
5. On September 27, 2004, as amended on September 30, 2004, Westar submitted an updated market power analysis in compliance with the Commission's Implementation

Order.¹ Westar's updated market power filing indicated that it passed the pivotal supplier screen in all markets considered, and that it passed the wholesale market share screen in all of the markets except for its home control area and the Midwest Energy, Inc. (Midwest) and Aquila Networks-West Plains Kansas (WPEK) control areas.

6. On March 23, 2005, the Commission instituted a proceeding under section 206 of the Federal Power Act (FPA)² concerning the justness and reasonableness of Westar's market-based rates in the Westar, Midwest, and WPEK control areas. Westar proposed to use cost-based measures to address the Commission's requirements to mitigate market power. On September 26, 2006, the Commission issued an order, finding that Westar should make sales with terms of more than one year on an embedded cost-of-service basis.³

7. Westar states that, in light of the anticipated July 31, 2008 termination date of the WES Agreement and the Commission's findings in the Mitigation Order, it engaged in extensive negotiations with Elwood regarding the terms and conditions under which Westar would provide capacity and firm energy to Elwood. According to Westar, the proposed Formula Rate Agreement is the result of those discussions. Westar further states that the Formula Rate Agreement, by its terms, does not become effective until the first day of the month following the date that a Commission order becomes final approving without condition or modification, or accepting without condition or modification, the Formula Rate Agreement.

II. Description of Filing

8. Under the proposed Formula Rate Agreement, Westar will sell capacity and firm energy to Elwood. Westar will provide generation-related service at a cost-based formula rate under which (a) the Variable Operations and Maintenance (VOM) component of the Energy Charge and the Demand Charge will change from year to year;⁴ and (b) the

¹ *Acadia Power Partners, LLC*, 107 FERC ¶ 61,168 (2004) (Implementation Order), *order on reh'g*, 110 FERC ¶ 61,178 (2005). The Implementation Order addressed the procedures for implementing the Commission's new interim generation market power analysis and mitigation policy announced in the Commission's April 14, 2004 Order in *AEP Power Marketing, Inc.*, 107 FERC ¶ 61,018 (2004).

² 16 U.S.C. § 824e (2000).

³ *Westar Energy Inc.*, 116 FERC ¶ 61,219 (2006) (Mitigation Order), *order on reh'g* 123 FERC ¶ 61,123 (2008).

⁴ The components of these charges are set forth in Appendix 1 to Attachment D of the Formula Rate Agreement.

Energy Charge will change from month to month.⁵ Westar will also arrange for transmission, ancillary and distribution services and pass through the costs it incurs for arranging those services. The initial term of the Formula Rate Agreement is for twenty years and shall continue year to year thereafter until cancelled by one of the parties, with three years prior written notice to the other party.

9. Under the Formula Rate Agreement, the Demand Charge and VOM Charge will not exceed Westar's average embedded cost. The Energy Charge includes the VOM Charge and fuel-related costs.

10. The Demand Charge for each contract year, except the final contract year, will be the lesser of (a) the latest Demand Charge produced by the formula rate template included on Appendix 1 to Attachment D; or (b) 110 percent of the prior contract year's Demand Charge.⁶ Westar proposes to derive the return on equity (ROE) annually under a formula that adds 535 basis points to the average of the daily Moody's Investors Service's Long-Term Baa Corporate Bond Index for December, subject to a floor and a ceiling of 9 percent and 18 percent, respectively. Under the proposed Formula Rate Agreement, a "public interest" standard of review will govern any proposed changes to the proposed ROE methodology.⁷

11. Westar states that Westar and Elwood entered into the subject Settlement Agreement to provide for the continuation of the WES Agreement during the period that the Formula Rate Agreement is pending Commission action. Westar emphasizes that by providing that the WES Agreement continue both Westar and Elwood will avoid any confusion and uncertainty as to the terms that will govern the service that Westar provides Elwood during this period.

III. Notice of Filing and Responsive Pleadings

12. Notice of Westar's filings was published in the *Federal Register*, 73 Fed. Reg. 37,947 (2008), with interventions and protests due on or before July 14, 2008. On

⁵ The Energy Charge will be subject to a true-up set forth in Attachment D of the Formula Rate Agreement.

⁶ The Demand Charge for the final contract year will be the latest Demand Charge produced by the formula rate template.

⁷ Article XII.2 of the Formula Rate Agreement.

July 14, 2008, Occidental Chemical Corporation and Occidental Power Marketing, L.P. (collectively, Occidental) filed a timely motion to intervene and protest and a motion to consolidate this proceeding with Docket No. ER08-808-000.⁸

13. Occidental argues that Westar incorrectly filed the Formula Rate Agreement under Rule 207(a)(5) of the Commission's Rules of Practice and Procedure.⁹ Occidental explains that Westar's rate filing is for new service with an existing customer and contends that Westar's filing must comply with the requirements set forth in section 35.13 of the Commission's regulations.¹⁰ Occidental maintains that Westar has failed to comply with these regulations.

14. Occidental states that Westar's proposed rate of return on common equity is not cost-based and unjust and unreasonable. Occidental asserts that Westar has not explained its rationale for applying the 535 basis point adder, nor has it shown it is an appropriate measure of Westar's risk profile now or in the next 20 years under the Formula Rate Agreement. Lastly, Occidental asserts that Westar's proposed cap on Demand Charge increases is inconsistent with the embedded cost rate for long term sales as determined in the Mitigation Order.

15. Occidental asserts that Westar has failed to provide any incremental cost information or any assurance that captive customers will not subsidize the cost of serving Elwood. Specifically, Occidental contends that Westar failed to provide any assurance that its customers without caps on increases in their charges will not subsidize service to Elwood if Westar's costs exceed the Demand Charge under the Formula Rate Agreement due to the 10 percent cap on Demand Charge increases. Occidental contends that, because the Formula Rate Agreement may involve a subsidy from captive customers, it may unjustly support Westar's wholesale sales activity, thus frustrating competition by giving Westar an unduly competitive advantage.

16. Occidental asks the Commission either to reject Westar's filing or to set it for hearing. Occidental further requests that the Commission direct Westar to file all of the information required by section 35.13 of the Commission's regulations.

⁸ On June 6, 2008, the Commission issued an order establishing hearing and settlement judge procedures in Docket No. ER08-808-000, wherein Westar proposed an almost identical Formula Rate Agreement with the City of Mindenmines, Missouri. *See Westar Energy, Inc.*, 123 FERC ¶ 61,252 (2008).

⁹ *See* 18 C.F.R. § 385.207(a)(5) (2008).

¹⁰ *See* 18 C.F.R. § 35.1(c) (2008).

17. In its motion to consolidate, Occidental requests that the Commission consolidate this proceeding with the ongoing proceeding in Docket No. ER08-808-000, stating that such consolidation will promote administrative efficiency by saving time and resources. Further, Occidental emphasizes that consolidation will ensure that the issues are considered in a comprehensive manner, at one time, without the need for multiple successive proceedings.

IV. Discussion

A. Procedural Matters

18. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2008), Occidental's timely, unopposed motion to intervene serves to make it a party to this proceeding.

B. Hearing and Settlement Judge Procedures

19. Occidental's argument that Westar incorrectly filed the Formula Rate Agreement because it did not comply with the requirements of section 35.13 of the Commission's regulations amounts to an argument that Westar's filing is patently deficient. Having evaluated Westar's filing, we find that it minimally satisfies our threshold filing requirements and is not patently deficient. Therefore, we shall deny the request for rejection.

20. Westar's proposed Formula Rate Agreement raises issues of material fact that cannot be resolved based on the record before us, and that are more appropriately addressed in the hearing and settlement judge procedures ordered below.

21. We agree with Occidental that Westar has not adequately supported its proposed formula-based ROE. Westar's reliance on *Indiana Michigan Power Co.*¹¹ is misplaced. *Indiana Michigan Power Co.* is an unpublished letter order and does not constitute legal precedent binding on the Commission.¹² Notwithstanding *Indiana Michigan Power Co.*, the Commission's policy is that ROEs must be supported through a discounted cash flow (DCF) analysis subject to review by this Commission and that increases in cost-based

¹¹ *Indiana Michigan Power Co.*, Docket No. ER06-140-000 (Feb. 15, 2006) (unpublished letter order).

¹² See, e.g., *Idaho Power Co.*, 95 FERC ¶ 61,482 (2001); *Cambridge Electric Light Co.*, 95 FERC ¶ 61,162 (2001).

ROEs must be accompanied by individual filings under FPA section 205.¹³ The standard to deviate from this general policy is very high. To be specific, in order for the administrative law judge to approve the formula-based ROE, Westar must provide unequivocal evidence indicating that the proposed ROE is just and reasonable,¹⁴ despite our policy to the contrary.

22. In addition, in light of *Maine Pub. Util. Comm'n v. FERC*, 520 F.3d 464 (D.C. Cir. 2008), the Commission may not accept the standard of review as currently written with regard to third parties in this new agreement. As such, the standard of review provision in the Formula Rate Agreement is accepted conditioned on the parties revising the standard of review applicable to third parties consistent with the Commission's decision in *Duke Energy Carolinas, LLC*, 123 FERC ¶ 61,201, at P 10 & n.10 (2008). Westar should, within thirty days of the date of this order, file a revised standard of review provision consistent with this precedent. Thus, the standard of review is not set for hearing.

23. Our preliminary analysis indicates that Westar's proposed Formula Rate Agreement has not been shown to be just and reasonable and may be unjust, unreasonable, unduly discriminatory or preferential, or otherwise unlawful. Therefore, we will set Westar's proposed Formula Rate Agreement (filed as a *pro forma* rate schedule) for hearing and settlement judge procedures.¹⁵

24. Based on the record before us, it is unclear whether the common questions of law or fact are such that consolidation of this matter with Docket No. ER08-808-000 will result in administrative efficiencies. Therefore, we will reserve the issue of whether to grant Occidental's motion to consolidate these two matters for determination in the course of the hearing or settlement judge procedures.

¹³ See, e.g., *Southern California Edison Co.*, 92 FERC ¶ 61,070, at 61,262-63 (2000); *Midwest Independent Transmission System Operator, Inc.*, 100 FERC ¶ 61,292 (2002), *order affirming initial decision*, 102 FERC ¶ 61,143 (2003), *reh'g denied*, 106 FERC ¶ 61,302 (2004), *order on remand*, *Public Serv. Comm'n of the Commonwealth of Kentucky v. FERC*, 397 F.3d 1004 (2005); and *New England Power Co.*, 31 FERC ¶ 61,378, at 61,841-42 (1985).

¹⁴ *New England Power Co.*, 31 FERC ¶ 61,378, at 61,841-42, n.11 (discussing limited exceptions to the general policy against automatically adjustable rates).

¹⁵ Ultimately, actual tariff sheets would need to be filed to replace the *pro forma* tariff sheets.

25. While we are setting these matters for a trial-type evidentiary hearing, we encourage the parties to make every effort to settle their dispute before the hearing procedures are commenced. To aid the parties in their settlement efforts, we will hold the hearing in abeyance and direct that a settlement judge be appointed, pursuant to Rule 603 of the Commission's Rules of Practice and Procedure.¹⁶ If the parties desire, they may, by mutual agreement, request a specific judge as the settlement judge in the proceeding; otherwise the Chief Judge will select a judge for this purpose.¹⁷ The settlement judge shall report to the Chief Judge and the Commission within 30 days of the date of the appointment of the settlement judge, concerning the status of settlement discussions.¹⁸ Based on this report, the Chief Judge shall provide the parties with additional time to continue their settlement discussions or provide for commencement of a hearing by assigning the case to a presiding judge. Should the settlement judge ultimately determine that a hearing is warranted, Westar shall file a full case in chief pursuant to the Commission's regulations to support its proposed rate structure at hearing.

26. In order to ensure continued service to Elwood, we will accept Westar's proposal that the WES Agreement remain in effect while the Formula Rate Agreement is pending before the Commission.

¹⁶ 18 C.F.R. § 385.603 (2008).

¹⁷ If the parties decide to request a specific judge, they must make their joint request to the Chief Judge by telephone at (202) 502-8500 within five days of the date of this order. The Commission's website contains a list of Commission judges and a summary of their background and experience (www.ferc.gov – click on Office of Administrative Law Judges).

¹⁸ The issues in this matter may bear significant relationship to those posed in Docket No. ER07-1344-000. On June 27, 2008, the Settlement Judge in that matter submitted a Status Report indicating that it appeared that a settlement may be forthcoming in that docket. The parties and Chief Judge should be aware of the status of those proceedings in determining whether or when to initiate procedures here. If a settlement is filed in Docket No. ER07-1344-000, the Chief Judge should consider deferring initiation of hearing procedures here pending Commission action on the settlement.

The Commission orders:

(A) Westar's proposed Formula Rate Agreement is hereby set for hearing and settlement judge procedures.

(B) Westar is directed to file a revised standard of review provision, as discussed in the body of the order, within thirty (30) days of the date this order issues.

(C) Pursuant to the authority contained in and subject to the jurisdiction conferred upon the Federal Energy Regulatory Commission by section 402(a) of the Department of Energy Organization Act and by the Federal Power Act, particularly sections 205 and 206 thereof, and pursuant to the Commission's Rules of Practice and Procedure and the regulations under the Federal Power Act (18 C.F.R., Chapter I), a public hearing shall be held concerning Westar's proposed Formula Rate Agreement. However, the hearing shall be held in abeyance to provide time for settlement judge procedures, as discussed in Ordering Paragraphs (D) and (E) below.

(D) Pursuant to Rule 603 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.603 (2008), the Chief Administrative Law Judge is hereby directed to appoint a settlement judge in this proceeding within fifteen (15) days of the date of this order. Such settlement judge shall have all powers and duties enumerated in Rule 603 and shall convene a settlement conference as soon as practicable after the Chief Judge designates the settlement judge. If the parties decide to request a specific judge, they must make their request to the Chief Judge within five (5) days of the date of this order.

(E) Within thirty (30) days of the appointment of the settlement judge, the settlement judge shall file a report with the Commission and the Chief Judge on the status of the settlement discussions. Based on this report, the Chief Judge shall provide the parties with additional time to continue their settlement discussions, if appropriate, or assign this case to a presiding judge for a trial-type evidentiary hearing, if appropriate. If settlement discussions continue, the settlement judge shall file a report at least every sixty (60) days thereafter, informing the Commission and the Chief Judge of the parties' progress toward settlement.

(F) If settlement judge procedures fail and a trial-type evidentiary hearing is to be held, a presiding judge, to be designated by the Chief Judge, shall, within fifteen (15) days of the date of the presiding judge's designation, convene a prehearing conference in these proceedings in a hearing room of the Commission, 888 First Street, NE, Washington, DC 20426. Such a conference shall be held for the purpose of establishing

a procedural schedule. The presiding judge is authorized to establish procedural dates and to rule on all motions (except motions to dismiss) as provided in the Commission's Rules of Practice and Procedure.

By the Commission. Commissioner's Kelly and Wellinghoff dissenting in part with a separate joint statement attached.

(S E A L)

Kimberly D. Bose,
Secretary.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Westar Energy, Inc.

Docket No. ER08-1149-000

(Issued August 20, 2008)

KELLY and WELLINGHOFF, Commissioners, dissenting in part:

The parties to the Agreements before us request that the Commission apply a just and reasonable standard of review with the exception of certain specific provisions. In those instances, including future changes to the return on equity and standard of review provisions, the parties request that the Commission apply the “public interest” standard of review to changes sought by any of the parties, a non-party, or the Commission acting *sua sponte*.

The majority finds that, in light of the U.S. Court of Appeals for the District of Columbia Circuit’s (D.C. Circuit) decision in *Maine Public Utilities Commission v. FERC*,¹ the Commission may not accept the parties’ proposed standards of review. The majority sets the other provisions of the Agreements for hearing, but accepts the standard of review provisions, conditioned upon the parties revising them to be consistent with the Commission’s decision in *Duke Energy Carolinas, LLC*.²

We continue to disagree with the majority’s characterization of the D.C. Circuit’s holding in *Maine PUC* as to the applicability of the “public interest” standard. For the reasons set forth in our dissents in *Duke Energy Carolinas, LLC* and *Westar Energy, Inc.*,³ we respectfully dissent in part.

Suede G. Kelly
Commissioner

Jon Wellinohoff
Commissioner

¹ 520 F.3d 464 (D.C. Cir. 2008) (*Maine PUC*).

² 123 FERC ¶ 61,201 (2008).

³ 123 FERC ¶ 61,252 (2008).